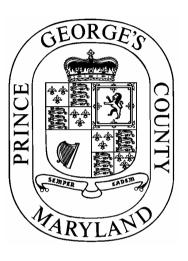
FINANCIAL SECTION

This section contains the Independent Auditors' Report, Management's Discussion and Analysis (MD&A), the Basic Financial Statements, Required Supplementary Information, and the Combining and Individual Fund Statements and Schedules.



MANAGEMENT'S DISCUSSION AND ANALYSIS

Management is pleased to present this narrative overview and analysis of Prince George's County's financial activities for the fiscal year ended June 30, 2006. We suggest using this information along with additional information furnished in the letter of transmittal (located in the Introductory Section of this report) to profile our operations. The following discussion focuses on the County's primary government and, unless otherwise noted, component unit information is not included.

FINANCIAL HIGHLIGHTS

- > Prince George's County's assets exceeded its liabilities at June 30, 2006 by \$1.5 billion (net assets). The primary government has a negative unrestricted net asset balance of \$305.9 million, mainly because of debt related to assets owned by its component units the Board of Education and the Community College.
- > The County's total net assets increased by \$105.4 million from the previous year. Net assets of governmental activities increased \$79.2 million, while the net assets of business-type activities increased \$26.3 million.
- > At June 30, 2006, Prince George's County's governmental funds report combined ending fund balances of \$643.3 million, an increase of \$218.4 million in comparison to the previous fiscal year. Of this amount, \$385.6 million remains in various funds of the County as unreserved.
- > At June 30, 2006, unreserved fund balance for the general fund was \$244.8 million, which represents approximately 19.3% of total general fund expenditures for fiscal year 2006.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to Prince George's County Government's financial statements, which include government-wide and fund statements, as well as notes to the financial statements.

Government-Wide Financial Statements

Similar to private-sector reporting, government-wide financial statements are designed to provide a broad overview of the financial position of Prince George's County. They include a **statement of net assets** and a **statement of activities.** These statements appear on pages 17 and 18 of this report.

The statement of net assets shows the County's assets less its liabilities at June 30, 2006. The difference between these assets and liabilities is reported as net assets. Changes in net assets over time may be helpful in indicating an improving or deteriorating financial position.

The statement of activities follows the statement of net assets and presents information on how net assets changed during the fiscal year. The statement presents all underlying events, which give rise to the change, regardless of the timing of the related cash flows.

Both statements distinguish functions of Prince George's County that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The government-wide financial statements of Prince George's County (known as the primary government) include general government, public safety, public works and transportation, health, public welfare, and education. The government-wide financial statements also include the legally separate component units for which the County is financially accountable. Financial information for these component units is reported separately from the primary government.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Like other state and local governments, Prince George's County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the County government can be divided into three categories: governmental, proprietary and fiduciary.

Governmental funds – Governmental funds, presented on pages 19 to 24, essentially account for the same functions as those reported under the governmental activities in the government-wide financial statements. However, this set of financial statements focuses on events that produce near-term inflows and outflows of spendable resources as well as on the balances of spendable resources available at the end of the fiscal year and is a narrower focus than the government-wide statements. This information may be useful in evaluating the County's near-term financing requirements and available resources.

By comparing functions between the two sets of statements for governmental funds and governmental activities, readers can discern the long-term impact of near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statements of revenue, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison.

Governmental funds individually presented in the County's basic financial statements include three major funds: the General Fund, the Capital Projects Fund, and the Federal and State Aided Programs Fund. The remaining five funds have been combined and presented in one column as "Other Governmental Funds." Combining statements for these other governmental funds are presented on pages 105 to 108 of this report.

Proprietary funds – Prince George's County maintains two different types of proprietary funds: enterprise and internal service funds. These funds are included on pages 25 to 29 of this report.

Enterprise funds are used to report, in detail, the same information presented as business-type activities in the government-wide financial statements. The County uses enterprise funds to account for solid waste and stormwater management, both of which are considered major funds of the County. Internal service funds are an accounting device used to account for self-insurance, vehicle maintenance, and computer services. Because the internal service funds predominantly benefit governmental rather than business—type functions, they have been included within the governmental activities in the government-wide statements. The internal service funds are presented in total in the fund financial statements, but may be viewed separately in the combining statements on pages 109 to 113 in this report.

Fiduciary funds – Prince George's County uses fiduciary funds to account for resources held for the benefit of parties outside the County government. Although these funds are presented with the fund statements, they do not appear in the government-wide financial statements because the resources of these funds are not available to support the programs of the County. The accounting method used for fiduciary funds is much like that used for proprietary funds. These funds are presented on pages 30 and 31 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in both government-wide and fund financial statements. Notes are presented on pages 33 to 85 of this report.

Other Information

This report also includes required supplementary information related to the funding progress of the County's Pension Trust Funds. This information is included on pages 87 and 88.

Combining and individual statements and schedules referred to earlier, which present more detailed views of nonmajor funds, internal service funds, and nonmajor component units are presented on pages 89 to 125.

Additional information about the County, which may be of interest to the reader, is found in the Statistical Section of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, changes in net assets over time is a useful indicator of a business enterprise's financial position. The County's total net assets as of June 30, 2006 were \$1.53 billion. Investment in capital assets such as land, roads, bridges, buildings, machinery and equipment accounts for \$1.49 billion of net assets. The amount is presented less any outstanding debt related to the acquisition and accumulated deprecation of those assets. The County uses capital assets to provide services to the citizens, and consequently, these assets are not available for future spending. Although assets are reported net of related debt, the capital assets themselves cannot be used to liquidate that liability, and other resources will be needed to repay any associated debt.

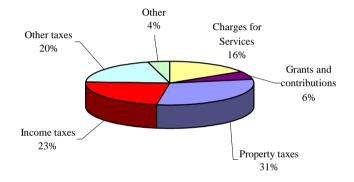
Schedules of Net Assets June 30, 2006 and 2005

(in thousands)

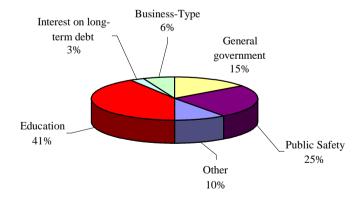
		Governmental activities		Business-type activities		Total	
		2006	2005	2006	2005	2006	2005
Current and other assets	\$	978,398	696,092	150,131	143,131	1,128,529	839,223
Capital assets		1,793,618	1,758,006	215,893	199,034	2,009,511	1,957,040
Total assets		2,772,016	2,454,098	366,024	342,165	3,138,040	2,796,263
Long-term liabilities	·-	1,085,912	914,232	155,047	158,251	1,240,959	1,072,483
Other liabilities		342,226	275,157	24,735	23,939	366,961	299,096
Total liabilities		1,428,138	1,189,389	179,782	182,190	1,607,920	1,371,579
Net assets							
Invested in capital assets, net							
of related debt		1,370,963	1,361,494	114,802	98,064	1,485,765	1,459,558
Restricted		327,802	237,414	22,430	19,001	350,232	256,415
Unrestricted (deficit)	_	(354,887)	(334,199)	49,010	42,910	(305,877)	(291,289)
Total net assets	\$	1,343,878	1,264,709	186,242	159,975	1,530,120	1,424,684

Restricted net assets are resources subject to external restriction on how they may be used to meet the County's ongoing obligations to citizens and creditors. As noted earlier, the County's net asset deficit in governmental activities unrestricted net assets is primarily attributable to outstanding debt that has been issued on behalf of the County's component units. The majority of this debt is for the Board of Education as the County continues to issue bonds to finance school construction projects. Counties in the State of Maryland issue debt for school construction; however, the buildings are owned by the County's Board of Education. All other governmental and business-type activities had positive net asset balances as of June 30, 2006.

Revenue by Source FY 2006



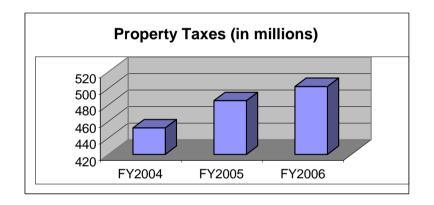
Expenditures by Function FY 2006

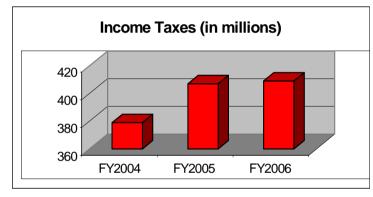


Governmental Activities

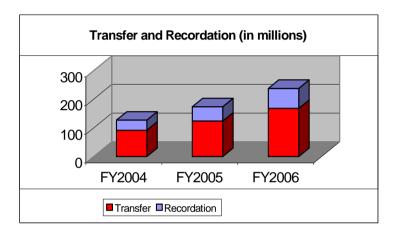
Net assets for the County's governmental activities increased by approximately \$79.2 million in fiscal year 2006.

The County's total revenues from governmental activities was approximately \$1.67 billion, including the extraordinary item of \$7.5 million, in fiscal year 2006 (approximately \$118.4 million greater than fiscal year 2005.) Property and income taxes make up approximately 54 percent of this revenue. Property taxes increased by approximately \$24.4 million or 5.1 percent reflecting a steady increase in property values and is consistent with the 5.6 percent increase in fiscal year 2005. Income taxes were flat decreasing by less than \$0.7 million.





Transfer and recordation taxes (\$238.1 million), telecommunications taxes (\$48.3 million), and energy taxes (\$48.3 million) comprise the majority of the remaining other taxes. Other taxes increased by approximately \$73.3 million or 25.8 percent. The \$63.8 million increase in transfer and recordation tax is due to the continued increase in refinancing of mortgages.



The County's total expenses from governmental activities was approximately \$1.59 billion in fiscal year 2006 (approximately \$182.6 million greater than fiscal year 2005.) The categories experiencing the largest increases were general government (approximately \$63.9 million) and public safety (approximately \$36.3 million). General government expenditures increased approximately 35.0 percent. A large percentage of the increase relates to funds transferred to capital projects for the County and the Redevelopment Authority (approximately \$58.7 million combined). Public safety expenditures increased by approximately 9.3 percent. Contributions to fund the public safety pension plans increased over \$14 million.

Schedule of Changes in Net Assets For the years ended June 30, 2006 and 2005

(in thousands)

	_	Governmental activities		Business-type	activities	Total	
Revenues:		2006	2005	2006	2005	2006	2005
Program Revenue:			_				_
Charges for services	\$	207,838	215,745	84,919	83,348	292,757	299,093
Operating grants and contributions		93,608	96,370	-	-	93,608	96,370
Capital grants and contributions		20,847	17,003	434	838	21,281	17,841
General revenue:							
Property taxes		501,372	476,947	27,557	25,224	528,929	502,171
Income taxes		409,189	409,881	-	-	409,189	409,881
Other taxes		357,368	284,041	-	-	357,368	284,041
Other revenues		67,978	47,301	6,207	3,797	74,185	51,098
Total revenues		1,658,200	1,547,288	119,117	113,207	1,777,317	1,660,495
Expenses:			_			_	_
General government		246,280	182,388	-	-	246,280	182,388
Public safety		424,904	388,604	-	-	424,904	388,604
Public works and transportation		83,591	67,027	-	-	83,591	67,027
Health		63,443	55,967	-	-	63,443	55,967
Public welfare		22,386	23,964	-	-	22,386	23,964
Education		697,121	644,515	-	-	697,121	644,515
Interest on long-term debt		48,773	41,387	-	-	48,773	41,387
Solid waste		-	-	73,753	81,850	73,753	81,850
Stormwater management		-		27,534	26,416	27,534	26,416
Total expenses		1,586,498	1,403,852	101,287	108,266	1,687,785	1,512,118
Special and extraordinary items:							
Gain on capital asset due to change in estimate		-	-	8,437	-	8,437	-
Asset impairment / insurance recovery		7,467	(5,837)	<i>.</i> -	-	7,467	(5,837)
Increase in net assets		79,169	137,599	26,267	4,941	105,436	142,540
Net assets - beginning of year		1,264,709	1,127,110	159,975	155,034	1,424,684	1,282,144
Net assets - end of year	\$	1,343,878	1,264,709	186,242	159,975	1,530,120	1,424,684

Business-type Activities

Business-type activities increased the County's net assets by approximately \$26.3 million in fiscal year 2006. Key elements of this increase are as follows:

- > Total operating expenses for the Solid Waste Fund decreased by approximately \$8.1 million or 9.9 percent. This was primarily a result of an overall decrease of depreciation and landfill postclosure expenses. Depreciation expense, which includes the landfill, decreased by \$7.4 million or 89.8 percent. This is a result of the increase in capacity of the landfill, thereby increasing its useful life, resulting in a gain of approximately \$8.4 million. The decrease of over \$2.8 million for landfill postclosure is also a result of the change in capacity.
- > Total nonoperating revenue for the Stormwater Management Fund increased by approximately \$3 million or 12.66 percent. This was primarily a result of a 9.2 percent increase in property taxes which was a result of new development. In addition, interest income increased 100.8 percent due to higher rates.

FINANCIAL ANALYSIS OF GOVERNMENT FUNDS

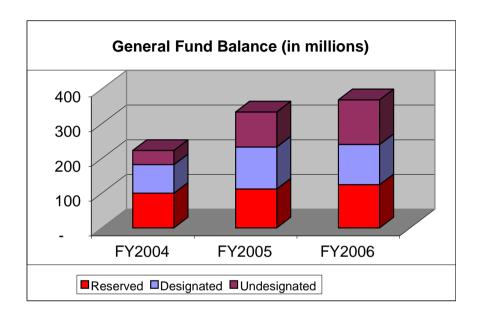
Governmental Funds

As noted earlier, Prince George's County uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. Governmental funds provide information on near-term inflows, outflows, and balances of spendable resources. In assessing Prince George's County's financing requirements, unreserved fund balance is a particularly useful measure of net resources available for spending at the end of the fiscal year.

As of June 30, 2006, County governmental funds reported combined fund balances of \$643.3 million, an increase of \$218.4 million in comparison to the prior year balances. Governmental funds reserved \$257.8 million to meet current commitments in the next fiscal year, including \$39.2 million for contracts and purchase orders not received at year-end, \$115.0 million for a charter-mandated contingency reserve (Rainy Day Fund), \$95.3 million for school construction, and \$8.3 million for other purposes.

The General Fund is the chief operating fund of the County. At June 30, 2006, total fund balance in the general fund was \$369.0 million of which \$244.8 million was unreserved. The General Fund balance increased by \$35.0 million as a result of current fiscal year operations. The following key factors were responsible for the growth:

- > Homeowners continued to take advantage of lower interest rates on mortgages, which generated transfer and recordation taxes of \$238.1 million. This amount exceeded the revised budget and the prior year total by \$97.6 million and \$63.8 million, respectively.
- > The County used the additional revenue to contribute \$43.2 million in pay-go funding (mainly for school projects) to the Capital Projects Fund and \$15.5 million to the Redevelopment Authority (a component unit) to assist in funding various redevelopment projects, including Suitland Manor and the African American Cultural Center in North Brentwood.



Capital Projects Fund expenditures totaled \$146.1 million for fiscal year 2006 compared to \$125.7 million in fiscal year 2005. There was an increase of \$22.2 million in spending on Board of Education projects. The largest expenditure was \$43.0 million spent on the Dr. Henry A. Wise, Jr. High School that opened in the fall of 2006. Two bond sales during fiscal year 2006 generated proceeds of \$224.8 million in fiscal year 2006, compared to no proceeds in fiscal year 2005. These factors led to a total increase in fund balance of \$184.6 million during the fiscal year.

Expenditures in the Federal and State Aided Programs Fund decreased by approximately \$3.9 million over fiscal year 2005. Major changes in grant funding during fiscal year 2006 include:

- > General Government expenditures decreased approximately \$5.9 million due to changes in housing and community development programs. A transfer of the HOPWA grant to the Housing Authority in December 2005 decreased costs by \$1.8 million in FY06). There was a loan disbursement of approximately \$2.1 million for Sec 108 EDI in fiscal year 2005, compared to no loans disbursements in fiscal year 2006. The HOME Program spent approximately \$1.4 million less in fiscal year 2006 due to a reorganization.
- > Health expenditures increased by approximately \$5.1 due to transfer of the Infants and Toddlers program from Family Service to the Health Department.
- New Homeland Security grants increased expenditures by \$2.2 million.

Proprietary Funds

Proprietary fund statements provide more detail for the County's business-type activities than the government-wide financial statements.

Enterprise Funds. At June 30, 2006, total net assets amounted to \$189.6 million for enterprise funds as compared to \$164.1 million at June 30, 2005. Unrestricted net assets of the Solid Waste Fund at the end of the year amounted to \$30.8 million, and those for the Stormwater Management Fund amounted to \$21.6 million. Total net assets increased by \$18.6 million in the Solid Waste Fund and by \$6.9 million in the Stormwater Management Fund.

Other factors concerning the finances of these two funds have already been addressed in the discussion of the County's business-type activities.

BUDGETARY HIGHLIGHTS

The County's final General Fund revenue budget exceeded the original budget by \$76.7 million. The County used the additional funding to cover costs of the increase pay-go funding for capital projects, new vehicles, and public safety. Details for these costs include:

- > Increase in compensation for public safety employees (\$37.6 million appropriation increase) due to overtime and increase in personnel.
- > \$10 million in additional funding for Dimensions Health Care Systems, Inc. as part on an agreement between the County and the State that allowed the hospital system to provide adequate care to all patients.
- > \$7.4 million transfer to the Vehicle Maintenance internal service fund to purchase new police and sheriff vehicles.
- > An additional \$10 million of transfers to capital projects mainly related to public schools.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets. The County's investment in capital assets for its governmental and business-type activities as of June 30, 2006 \$2.0 billion (net of accumulated depreciation.) This investment in capital assets includes land, buildings and improvements, equipment and vehicles, road networks, bridges, landfill property in service, and stormwater property in service. The total increase in the County's investment in capital assets for the current fiscal year was 2.7 percent (2.0 increase for governmental funds and 8.5% increase for business-type.)

Major capital asset events during the year include the following:

- > Three major road projects [Largo Metro Development (\$4.8 million), Contee Road (\$7.5 million), Ritchie Road (\$12.4)] and one major bridge project Columbia Park (\$10.0) were completed in 2006 and transferred to inventory.
- > Construction costs of \$3.7 million relating to the reconstruction of the Courthouse which was damaged on November 30, 2004. Project costs are expected to exceed \$40 million.
- Road and bridge project costs, including Ammendale & Virginia Manor Road III (\$6.2 million) increased construction in progress by \$14.0 million.

The County's capital assets, net of accumulated depreciation is presented in the following table as of June 30, 2006 and 2005:

	Governmenta	al activities	Business-typ	Business-type activities		Total	
	2006	2005	2006	2005	2006	2005	
Land	\$ 72,620,302	71,549,056	12,516,407	12,516,407	85,136,709	84,065,463	
Buildings and improvements	213,325,266	215,530,235	2,121,409	2,383,412	215,446,675	217,913,647	
Equipment	38,674,023	29,050,070	7,039,861	7,856,603	45,713,884	36,906,673	
Infrastructure	1,392,785,834	1,342,217,903	-	-	1,392,785,834	1,342,217,903	
Landfill property in service	-	-	31,636,005	18,796,732	31,636,005	18,796,732	
Stormwater property in service	-	-	58,749,856	61,005,838	58,749,856	61,005,838	
Construction in progress	76,213,353	99,658,248	103,829,350	96,475,331	180,042,703	196,133,579	
Total	\$ 1,793,618,778	1,758,005,512	215,892,888	199,034,323	2,009,511,666	1,957,039,835	

Additional information on Prince George's County's capital assets is located on pages 52 to 56 of this report.

Long-term debt. At the end of the current fiscal year, the County had total bonded debt outstanding of \$1.03 billion. Of this amount, \$1.01 billion comprises debt backed by the full faith and credit of the government. The remainder of the County's debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

Outstanding Debt

		Government	tal activities	Business-type activities		Total	
	_	2006	2005	2006	2005	2006	2005
General obligation bonds	\$	931,961,579	753,818,759	75,226,102	71,921,748	1,007,187,681	825,740,507
Revenue bonds	_			25,584,333	29,722,552	25,584,333	29,722,552
Total	\$_	931,961,579	753,818,759	100,810,435	101,644,300	1,032,772,014	855,463,059

Total bonded debt of Prince George's County Government increased by \$177.3 million (20.7%) from the previous fiscal year. The key factors in the increase are bond proceeds of \$233.0 million from bond sales in July 2005 and June 2006, and the retirement of \$55.7 million of General Obligation and Revenue Bonds.

The underlying ratings of the County's general obligation bonds as of June 20, 2006, were as follows:

	<u>Current Rating</u>
Fitch Ratings	_
Limited tax bonds	AA+
Unlimited tax bonds	AA+
Standard & Poor's	AA+
Moody's Investors Service, Inc.:	
(both for limited tax bonds	Aa2
and unlimited tax bonds)	

The County's Stormwater Management general obligation underlying bond ratings as of June 30, 2006, were as follows:

	<u>Current Rating</u>
Fitch Ratings	AA+
Standard & Poor's	AA+
Moody's Investors Service, Inc.	Aa2

The underlying ratings of the County's Solid Waste Management Refunding Revenue Bonds, series 2003, as of June 30, 2006, were as follows:

	<u>Current Rating</u>
Fitch Ratings	AA-
Standard & Poor's	AA-
Moody's Investors Service, Inc.	Aa3

Additional information on the County's long-term debt is located in note 12 starting on page 68 of this report.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Factors considered in preparing Prince George's County's budget for fiscal year 2007 included:

- > The unemployment rate in the County decreased from 4.7% in January of 2005 to 4.2% in January of 2006. The percentage is below the national average but slightly higher than the State unemployment rate.
- > The office vacancy rate in the County declined slightly from the same period of last year. The performance is in line with other jurisdictions in the region.
- Existing home transactions decreased by a double-digit rate (12%) in January 2006 compared with that in January 2005, which occurred for the first time during the past five years. Existing home prices for the same time period were up by 22%, which still represents a lower growth compared with that in most of the months in 2004 and 2005. With a similarly slowing-down trend in the whole DC Metropolitan Area, it is obvious that the housing markets are moderating off their peak.

During the current fiscal year, unreserved fund balance in the General Fund increased by \$22.8 million to a total of \$244.8 million. One factor impacting the increase was tax revenues that exceeded the budget by approximately \$118.3 million in fiscal year 2006. General fund reserves increased \$12.1 million mainly due to the increase in the contingency reserve. The County has appropriated \$24.8 million of the unreserved fund balance for fiscal year 2007.

Requests for Information

This financial report is designed to provide a general overview of Prince George's County, Maryland for those individuals with an interest in our government's finances. Address questions concerning any of the information provided in this report or requests for additional information to the Office of Finance, Accounting Division, Attention: Assistant Director, 14741 Governor Oden Bowie Drive, Suite 3151, Upper Marlboro, MD 20772. You can also reach us by fax at 301.952.3043 or send an email to: cmcurtis@co.pg.md.us.